

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 358

March 20, 1973

### SECTION 18685.05: UNDERPAYMENT OF ESTIMATED TAX

#### Syllabus:

Passage of AB-1 by the California Legislature introduced certain changes and modifications into the treatment of individual estimated income tax payments. Revenue and Taxation Code § 18685.05 provides that underpayment of estimated tax may result in imposition of a 6 percent per annum dividend to tax measured by the amount of underpayment.

The following questions are presented:

1. Is the 6 percent addition to tax for underpayment of estimated tax to be treated as a penalty?
2. If the addition to tax is to be treated as a penalty, from what point in time is interest assessed in the penalty?
3. Is interest to be assessed on the amount of underestimated tax, in addition to the penalty?

#### Decision:

1. Yes.
2. No interest is assessable.
3. No.

1. The term "addition to tax" used both in the federal scheme and in California, appears to be used interchangeably with the term "penalty." The various tax reporting services use the terms in the same sense. The term "penalty" is simply the more general term and can refer to impositions other than additions to tax such as fines or criminal action.

An "addition to tax" in fact is a penalty characterized by assessment of some flat amount or percentage of some amount in addition to the lawful tax imposed. The addition is imposed for some act or omission of the taxpayer in derogation of the tax law and usually may be assessed and collected in the same manner as the tax itself. Therefore, the 6 percent addition to tax upon the amount of underpayment is a penalty.

The penalty, although figured at 6 percent per annum is not an interest payment and is not deductible. [See Senate Committee Report, 1954 Code -- U.S. Code, Congressional and Administrative News, p. 5243.]

2. The amount of estimated tax payable is determined under Revenue and Taxation Code § 18556. The section in question, Revenue and Taxation Code § 18685.05, provides for the addition to tax based upon the amount of underpayment of estimated tax as determined by Revenue and Taxation Code § 18686.7 and § 18685.8.

Under normal circumstances interest is chargeable upon the amount of penalty assessed for nonpayment or underpayment of tax. However, Revenue and Taxation Code § 18696, although enacted in 1967, still appears to be controlling. Section 18696 provides:

Sections 18686 to 18695, inclusive, shall not apply to any failure to pay estimated tax required by Section 18556.

Interest imposed upon an assessable penalty is provided by Revenue and Taxation Code § 18689. Clearly then, the exculpatory provisions of Revenue and Taxation Code § 18696 exclude the imposition of interest on the penalty for underpayment of estimated tax imposed by Revenue and Taxation Code § 18686.05 since Revenue and Taxation Code § 18689 is included in those sections made inapplicable by Revenue and Taxation Code § 18696.

The federal statutes and regulations are not entirely clear on this point. Federal Regulation § 301.6601-1(f)(5) provides:

No interest shall be imposed for failure to pay estimated tax as required by section 59 of the Internal Revenue Code of 1939 or section 6153 or 6154 of the Internal Revenue Code of 1954.

The Internal Revenue Code sections referred to in this regulation are those to which the California estimated tax provisions are analogous. Therefore, it appears that the federal rule agrees with the California provisions for interest. The federal regulation cited, it should be noted, does not hold that interest shall not be imposed upon the amount of underestimated tax or upon the penalty imposed but rather that no interest shall be imposed at all due to failure to pay estimated tax.

Further, Mertens: Law of Federal Income Taxation -- Commentary § 6601:6, fn. 2, states:

No interest, however, is imposed under IRC (1954), Sec. 6601, with respect to the failure to pay the estimated tax. The only element of interest in such cases is the addition to tax provided in IRC (1954), Secs. 6153 and 6154.

This allusion to "interest" seems to imply only that the 6 percent penalty is assessed as a percentage in a manner similar to interest.

Then, in light of the express Revenue and Taxation Code provisions, and the federal regulations noted above, it is clear that there shall be no interest imposed upon the 6 percent per annum addition to tax provided by Revenue and Taxation Code § 18685.05.

3. With regard to question No. 3, an argument similar to that applied to question No. 2 can be made. First, imposition of interest upon underpayment of tax is provided by Revenue and Taxation Code § 18686. But Revenue and Taxation Code § 18686 is also made inapplicable to underpayment of estimated tax by the provisions of Revenue and Taxation Code § 18696.

Further, the argument based upon federal regulation, Fed. Reg. § 301.6601-1(f)(5) and Mertens regarding federal practice, may be applied here. To wit: no interest may be assessed upon the amount of underpayment of estimated tax.

In short, other than the addition to tax imposed upon the amount of underpayment of estimated tax provided in Revenue and Taxation Code § 18685.05, no additional assessments of interest will lie.

It is, of course, provided in AB-1 that Revenue and Taxation Code § 18685.05 shall have effect only after January 1, 1973. The above discussion applies to the prospective effect only. Prior to November 30, 1972, the estimate penalties are computed according to the prior law. For example, Revenue and Taxation Code § 18685.01 provides that a "penalty" of 10 percent of the amount of underpayment shall be added to the tax, and Revenue and Taxation Code § 18685.03 provides that "interest" of 6 percent per annum of the amount of underpayment may be added. In short, the restriction of penalties and interest associated with Revenue and Taxation Code § 18685.05 involves years subsequent to January 1, 1973.